NEW AGE

ACCOUNTING AND FINANCIAL MANAGEMENT

For I.T. Professionals

Y.P. SINGH

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Almighty :

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with whose blessings

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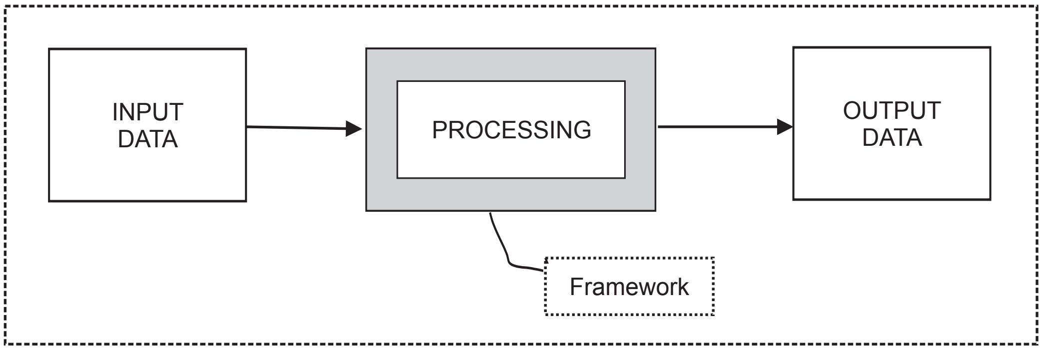
Preface

Management in India increasingly realises the use of accounting information for efficient management of business enterprises. Accounting is the science of measurement, analysis and communication. The designing of accounting systems, generating information and transmitting it to the management has expanded the scope of accounting and financial management.

This book has been written with a specific aim i.e., to cater to the needs of I.T. professionals (especially MCA students) of U.P. Technical University as well as other universities also.

I.T. comprises of Hardware part, Software part, and Information part. When we talk of business application software, we need to recognize and understand business information because problem recognition is the first step of software development. Accounting and Financial management are said to be the language of business because it enables the user to recognize and understand complexities associated with business information. This generates the need for study of Accounting and Financial management for I.T. professionals. This book has been written from system's point of view to facilitate I.T. professionals. A system comprises of three components as shown below:



Accounting as system takes business transactions/events as input data and process it within the framework of accounting principles and theories leading to generation of a number of reports (output data) which in turn acts as input data for financial management. **Financial management as system** process it within the framework of external environment and takes financial decisions (output data) viz. financing decisions, investment decisions and dividend decisions.

This book is also intended to assist beginners of management courses like B.B.A., B.Com. etc. and non-finance executives at work enabling them to understand business information (published in form of annual reports) and complexities associated with business organization. Furthermore, I am extremely grateful

to my godfather Dr. Girish Bihari (Ex-DGP, UP), CMD–IISE for his kind support and to New Age International Publishers, New Delhi for publishing this book so nicely and elegantly.

I convey my sincere thanks to my parents, my younger brother 'Raju' and my lovely friend for their support and encouragement.

Last but not least, I shall appreciate receiving comments and suggestions from readers for the improvement of the book.

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Accounting and Financial Management A Conceptual Framework

LEARNING OBJECTIVES

In this chapter we will study:

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Need for Accounting and Role of Accountant

- *Important terms*

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Utility of Accounting and Financial Management for Information Technology Professionals.

1.1 INTRODUCTION

- Organizations play an important role towards economic development.
- There are different types of organizations engaged in trading and manufacturing of goods/services.
- On the basis of motive, there may be two categories of organizations.

Organizations

Profit motive

All business organizations have profit motive (*The intention is to earn profit* (*profit = revenue – cost*))

Non-profit motive

Social organizations like club, trust, church, government hospital, and government schools have non-profit motive *(The intention is to earn revenue just to meet the cost of meeting the objectives i.e., no profit no loss.)*

- Both category of organizations (stated above) need money to fulfil their objectives *i.e.*, **to sustain and to grow.**
- There are two aspects of money (Fund).

Measurement of money

Management of money

- In a very limited sense **measurement of money** means how much money has been invested and where *i.e.*, record-keeping whereas, **management of money** means from where the money will come in and where it will go *i.e.*, procurement of fund (Financing decision) and utilization of fund (Investment decision).

  Thus,

- ***Accounting* is concerned with measurement of money.**

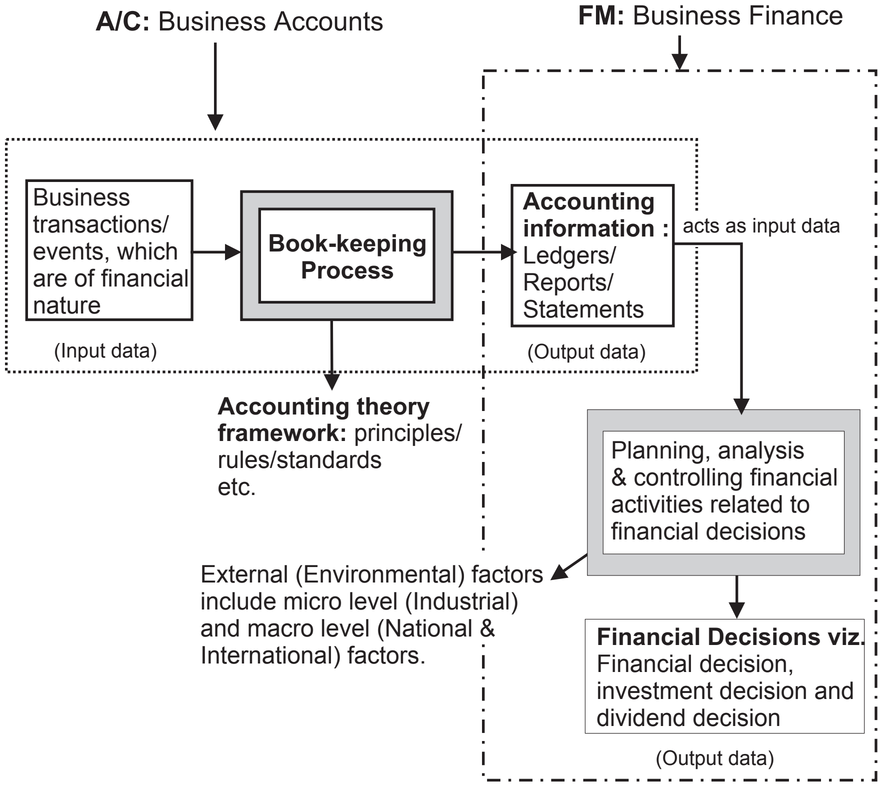
Financial Management is concerned with management of money.

'**Measurement of money**' in a broad sense means systematic record-keeping *i.e.,* maintaining books of accounts popularly known as book-keeping to generate such information which helps the interested groups/individuals in decision-making process *i.e.,* planning and controlling future activities.

Thus, in a nutshell, **Accounting** is information-generating system whose objective is to collect, process and report financial data of an organization to all the interested parties (internal and external both) for decision-making *i.e.,* planning and controlling financial activities.

'**Management of money**' in a broad sense includes all the financial decisions starting from planning to controlling financial activities under external/environmental factors (micro and macro both).

Thus, in a nutshell **Financial Management** is a decision-making system whose objective is planning, analysis and controlling financial decisions under external environmental factors (micro level and macro level both).



1.2 NEED FOR ACCOUNTING AND ROLE OF ACCOUNTANT

1.2.1 Need for Accounting

Accounting helps in knowing:

- What is the result of business operation after a certain interval *i.e.,* profit/loss?
- Financial health: Will the organization be able to meet commitments/obligations in the near future?
- What is fund/cash position?
- What the organization owns *i.e.,* assets to the organization.
- What the organization owes *i.e.,* liabilities of the organization.

and many more things, which help in decision-making process. This creates need for accounting.

Now, before going into details of accounting, first have a look on important terms frequently used in accounting. This will help in clear understanding of accounting concept and process.

1.2.2 Role of Accountant

With the help of proper accounting system, accountant helps the management in three ways:

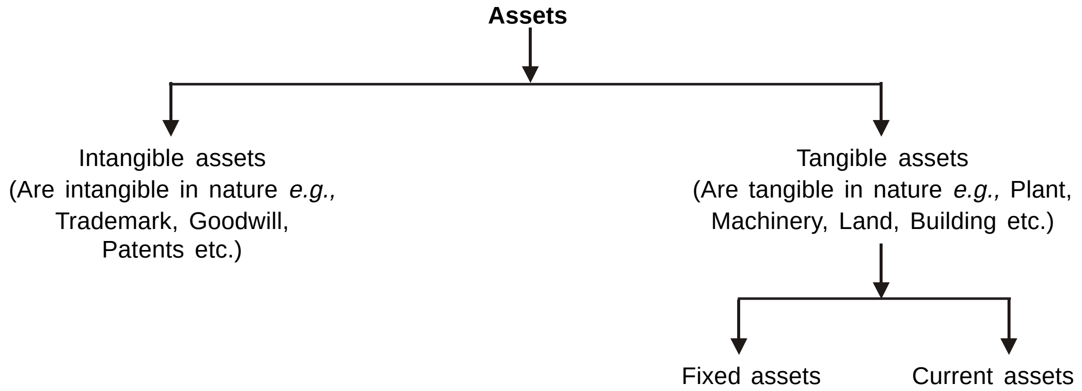
- Record-keeping/book-keeping
- Attention-directing
- Problem-solving
  - ❑ Accountant in his record-keeping role maintains books of account.
  - ❑ Accountant in his attention-directing role generates different statutory and non-statutory routine accounting information to bring the attention of management towards strength and weakness of the organization concerned.
  - ❑ Accountant in his problem-solving role helps the management by providing crucial information *i.e.,* non-routine information and number of alternate options to solve particular problem related to financial decisions (Financing, Investment and Dividend decision).

SOME IMPORTANT TERMS AND DEFINITIONS

Assets

Assets mean what an organization owns. In other words, anything which enables a business enterprise to get cash or a benefit in future, is an asset.

Classification of assets

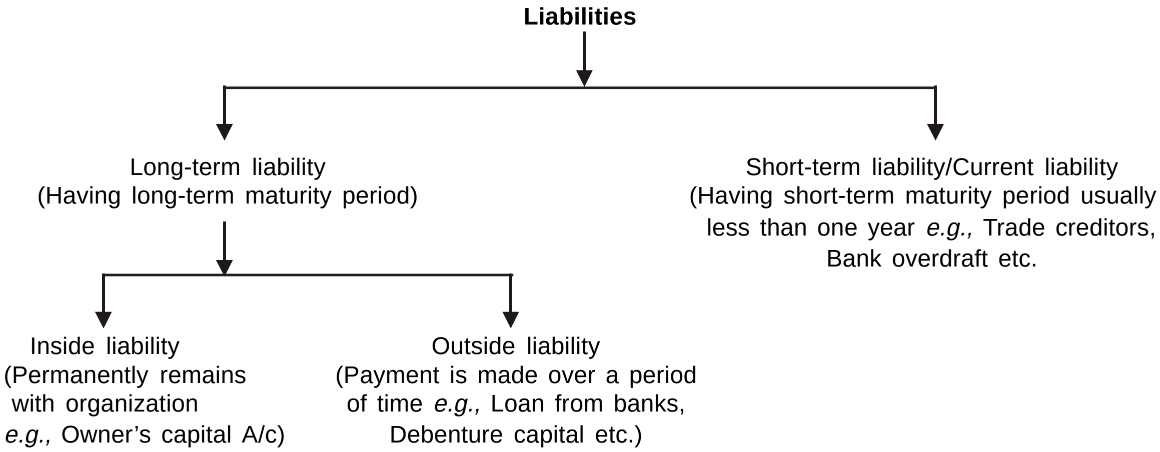


- **Fixed Assets:** Assets that are acquired for relatively long periods for carrying on the business of the enterprise and not meant for resale, *e.g.*, land, building, plant, and machinery etc.
- **Current Assets (CA):** Assets which are either in the form of cash or can be converted into cash within one year/short period *i.e.*, get converted into cash within one operating cycle of business *e.g.*, Cash, Inventories, Debtors, Bills Receivable, etc.
- **Liquid/Quick Assets:** Assets, which are immediately convertible into cash without much loss, *e.g.*, debtors, marketable securities, stamps etc. *i.e.*, except stock, all CA are liquid assets.

Liabilities

Liabilities mean what the organization owes. In other words, it is an amount, which a business owes and has to return or account for. For example, loan from banks, trade creditors, etc.

Classification of liabilities



Capital: It refers to the amount invested by the proprietor in business enterprises.

Revenue: It means income of a recurring nature from any source related to business.

Capital Expenditure: An expenditure, which has been incurred for the purpose of obtaining a long-term advantage for the business, *e.g.* expenditure incurred for purchase of fixed assets.

Revenue Expenditure: It denotes the cost of services and things used for generating revenue. In other words, all items of expenditure, whose benefit expires within a year or which have been incurred merely to maintain the business or to keep the assets in good working condition, is taken as revenue expenditure. For example, salaries and wages paid to employees, depreciation of business assets, maintenance expenses of motor vehicle, etc. Revenue expense is different from loss. An expense is supposed to bring some benefit to the firm, whereas a loss brings no benefit to the firm. For example, loss by theft, loss by fire, etc. While calculating the income or the profit of a business for a particular period, the revenue earned during that period is to be matched with the expense incurred in earning that revenue (matching concept).

Deferred Revenue Expenses: A revenue expenditure whose benefit is to continue for period of two or more years. Such expenditure is written off not in one year but over a period of two or three years. For example, expenditure incurred on heavy advertisement, preliminary expenditure, etc.

Creditor: Any person who gives credit is a creditor. The supplier supplying goods on credit is creditor. Creditor is one to whom the business owes. Owner is a creditor under 'Separate Entity Concept'.

Debtor: A person who owes money to the business is called a debtor. He is a customer to whom goods are sold on credit.